Texas Water Development Board

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**TO:** Board Members

**THROUGH:** Kevin Patteson, Executive Administrator

**FROM:** Amanda Landry, Development Fund Manager

**DATE:** February 9, 2015

**SUBJECT:** Briefing and discussion on the Bond Sale Results for State of Texas, General Obligation Water Financial Assistance Refunding Bonds Series 2015A ($33,045,000), 2015B Taxable ($69,985,000) and 2015C Economically Distressed Areas Program ($16,915,000).

## ACTION REQUESTED

No action is requested. This is a briefing and discussion on the results of the issuance of the referenced bonds.

## BACKGROUND

On September 18, 2014, the Board authorized staff to prepare for the issuance of up to $187,215,000 in Water Financial Assistance Refunding Bonds for the currently callable bond series. The TWDB approved the transaction by Resolution at the November 20, 2014 board meeting.

To maximize savings and reduce costs of issuance, the refunding bonds were combined into a single transaction sold under one Preliminary Official Statement. First Southwest Company served as financial advisor. Norton Rose Fulbright served as bond counsel and Escamilla & Poneck served as disclosure counsel. Morgan Stanley was the book-running senior manager, and Coastal Securities was the co-senior manager.

In preparation for implementing the refunding transactions, the TWDB evaluated the prepayment risk related to the call date options for the underlying borrower loans. The purpose of this analysis was to integrate flexibility to reduce the prepayment risk while still achieving debt service savings. Based on this analysis and given the history of prepayments in the Water Financial Assistance Fund, the Board approved a Plan of Finance that included the utilization of soft put bonds to provide the Board a more flexible alternative to applying prepayments when received. The Plan of Finance incorporated a balanced composition of fixed rate bonds and soft put bonds to strive for a structure that minimizes interest rate risk while allowing a new alternative to accommodate borrower prepayments.

While there is an established market for tax-exempt soft put bonds, the TWDB's recommended plan of finance included taxable soft put bonds, for which there is not an established market. Early in the process, First Southwest and their underwriting desk worked closely with Morgan Stanley to assist in framing the structure for potential investors and initiating price discovery.

Bond Review Board approval was received on December 31, 2014. The bonds priced on Tuesday, January 13, 2015, and the issued closed on February 5, 2015.

## BOND PRICING

Director Bruun and staff traveled to Morgan Stanley's New York offices to oversee the pricing of the bonds. Staff was joined by Anne Burger Entrekin and Richard Fox, the Board's financial advisors from First Southwest.

Pre-pricing discussions focused on recent market volatility, retail investor demand, and the upcoming calendar of issues coming to market. On Monday, January 12, 2015, the taxable process was initiated with indications of interest and pricing guidance. The order period generated approximately $264 million in orders. This level allowed yields to be lowered in certain maturities. In particular, the taxable soft put maturity was oversubscribed by 5 times allowing the indication of interest spread for that maturity to be lowered by 10 basis points. The tax-exempt pricing was done on Tuesday. Texas retail was the first priority, followed by national retail, group net and member orders. Retail was defined as individuals only. Additionally, strong investor interest resulted in over $199 million in orders which again allowed for yields in certain maturities to be reduced. The tax-exempt soft put was 6 times oversubscribed which allowed the yields to be reduced by 6 basis points. In additional to the pricing levels achieved, the TWDB was very pleased that the soft put bond pricing included an unprecedented one-year optional call date of February 1, 2016 at par. Finally, in a market where a 7.0% step-up rate is standard for tax-exempt bonds, the TWDB was able to negotiate a step-up rate of 6.5%. The step-up rate of 8.0% for the taxable bonds was 50 basis points below original projections.

Throughout the order period, staff reviewed orders and received periodic status reports. Staff noted for both underwriting firms the orders turned in, the types of orders, and the distribution of investor demand across maturities. Detail by maturity and a summary of the total orders and allotments by firm are available in Section 4 of the final pricing book.

## RESULTS

Key statistics are shown in the chart on the following page.

| Series | Designation | Par | Premium | NPV Savings $ | NPV Savings % |
|---|---|---|---|---|---|
| 2015 A | Tax-Exempt | $ 33,045,000 | $ 515,348 | $ 6,927,004 | 20.899093% |
| 2015 B | Taxable | $ 69,985,000 | $ 301,917 | $ 11,073,827 | 15.823144% |
| 2015 C | EDAP | $ 16,915,000 | $1,048,307 | $ 3,030,004 | 17.089701% |
| Total | | $ 119,945,000 | $1,865,573 | $ 21,030,836 | 17.400989% |

The savings noted above will change based on actual prepayments received. Additionally for purposes of illustration, the soft put bonds have been assumed to be remarketed on the tax-exempt bonds at the 10-year average of the 3 year MMD plus 0.30% and the taxable bonds at the 10 year average of the 3 year UST plus 0.80%.

In addition to the savings outlined above, the TWDB was successful in achieving other goals related to the transactions. TWDB was able to achieve the savings highlighted while issuing the soft-put bonds with a par call in one year. The shorter calls provide additional flexibility relative to potential prepayments. Debt service savings were structured in a manner that optimized savings while accomplishing longer term programmatic goals.

## COST SUMMARY

The final cost was $3.54 per bond, negotiated as follows:

| | $ Per Bond | Total $ Amount |
|---|---|---|
| Average Takedown | $3.13 | $375,169 |
| Underwriter's Expenses | 0.41 | 49,754 |
| Total Spread | $3.54 | $424,923 |

## PERFORMANCE ASSESSMENT

In general, the TWDB was pleased with the performance of the underwriting syndicate on the refunding transactions. Morgan Stanley led the transaction well, especially with performance from their desk on the soft-put series. The TWDB was particularity pleased to see that Coastal Securities submitted stock orders very early in the order period as well as retail and priority orders.